No. 10,550

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS H. WINGATE, as Receiver in Equity for Pacific Empire Holdings, Incorporated (a corporation of the State of Delaware),

Appellant,

vs.

PETER BERCUT, HENRI BERCUT, M. MAFFEI, and L. R. ARNOLD,

Appellees.

APPELLANT'S PETITION FOR A REHEARING.

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To the Honorable Curtis D. Wilbur, Presiding Judge, and to the Honorable Associate Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The Appellant Thomas H. Wingate, as receiver in equity for Pacific Empire Holdings, Inc., a corporation of the State of Delaware, feeling himself aggrieved by the opinion filed in this Court on December 29, 1944, comes now and respectfully petitions the Court for a rehearing in the above-entitled cause, and in support thereof sets forth the following grounds:

GROUNDS FOR PETITION.

(1) THE COURT ERRED IN REFUSING TO CONSIDER APPELLANT'S CONTENTION THAT ON JANUARY 8, 1941 PETER BERCUT WAS A FIDUCIARY OF THE HOLDING COMPANY AND THAT THE TRANSACTION OF JANUARY 8, 1941 WAS AND IS VOID BECAUSE IT CONSTITUTED A BREACH OF TRUST BY A FIDUCIARY.

The majority opinion of the United States Circuit Court for the Ninth Circuit appears to be premised on the concluding paragraph of the opinion by Stephens, Circuit Judge, that "since the evidence supports the finding that Bercut was not an officer or director of the Holding Company at the time he purchased the Merchants Ice shares, appellant's discussion of the fiduciary duties of corporate officers and directors is not in point".

It is respectfully submitted by the appellant that such a conclusion by the Court constitutes a denial, without consideration, of the very gist of plaintiff's cause of action, and is contrary to law.

The proposition before the Court was not so much whether or not Peter Bercut was an officer or director of the holding company on January 8, 1941, but rather whether he was a fiduciary of the Holding Company on January 8, 1941, and a determination of the question of whether or not he was a fiduciary of the Holding Company on said date is not at all dependent upon the proposition of whether the alleged oral resignation of Peter Bercut was legally effective to remove him from the office of officer and director of the Holding Company.

The real question before the Court was whether or not Peter Bercut continued to be a fiduciary of the Holding Company *even subsequent* to his alleged oral resignation because of his continuing relations to the Holding Company's subsidiaries and affiliated institutions. If, in fact, though not actually then an officer or director of the Holding Company, he nevertheless was a fiduciary of the Holding Company on January 8, 1941, by reason of his continuing relationship to it, then the legality of the transaction on January 8, 1941 is to be tested not by the ordinary rules of purchase and sale between strangers, as was done by the majority opinion in this case, but by the rules laid down in *Pepper v. Litton,* 308 U.S. 295.

A study of the above-entitled case cannot help but lead to the inevitable conclusion that from the inception of the alliance among defendants Maffei, Arnold and Bercut sometime between 1933 down through January 8, 1941, in one form or another, the three of them acted as a committee of management for the whole of the organization and Peter Bercut was not only an officer and director of the Holding Company and member of its executive committee clear down through and until the time that the trial Court found that he orally resigned, to Mr. Arnold, but also an officer and director of its subsidiary Pacific Empire Corporation, and at one time a director of its other subsidiary, California Pacific Service, Inc. In 1939, at his own request, he became a director of the controlled subsidiary Merchants Ice and Cold Storage Company, and of the affiliated banking institution,

Pacific National Bank of San Francisco, *representing the interests of the Holding Company in said corporations.* Under such circumstances Peter Bercut, by virtue of his own fiduciary relationship to all of the companies, acquired an intimate, confidential knowledge of the financial affairs and conditions of each of them and knew exactly the precarious nature of their existence. It is these circumstances that create the legal concept of what is designated a "fiduciary" and not the holding of any particular position or office.

The rule is well expressed in Section 2219 of the Civil Code of California, which provides:

> "Everyone who voluntarily assumes a relation of personal confidence with another is deemed a trustee, within the meaning of this chapter, not only as to the person who reposes such confidence, but also as to all persons of whose affairs he thus acquires information which was given to such person in the like confidence, or over whose affairs he, by such confidence, obtains any control."

In the case of *Bradley Co. v. Bradley,* 37 Cal. App. 263, at 267, Kerrigan, J. says:

> "From the facts narrated it certainly cannot be held that their relations were not confidential, nor that defendant was not the confidential agent of Bradley at the very time of the conveyance of the property. There are certain relationships from the existence of which the law infers special confidence, such as those of husband and wife, parent and child, guardian and ward, coun-

sel and client, etc., but it also exists in numerous cases where the facts proven will warrant the inference. (Brown v. Mercantile T. & D. Co., 87 Md. 377 (40 Atl. 256); Thomas v. Whitney, 186 Ill. 225 (57 N.E. 808, 810); Stepp v. Frampton, 179 Pa. St. 284 (36 Atl. 177, 179).) If these parties had been married at the time of the creation of the trust, the law would have presumed the relationship to be confidential, and the oral trust, therefore, enforceable; yet here the evidence shows that the confidence reposed was greater before than after marriage. We think that the trial court's conclusion that there existed at the time of the conveyance a confidential relationship between the parties is abundantly supported by the evidence."

In *Bacon v. Soule,* 19 Cal. App. 428, at page 434, Lennon, P.J. states the rule in the following appropriate words:

"The law relating to the subject of confidential relations has been so often declared and is generally so well understood that a mere reference to its underlying principles will suffice for the discussion and decision of the paramount point presented upon this appeal. A 'confidential relation' in law may be defined to be any relation existing between parties to a transaction wherein one of the parties is duty bound to act with the utmost good faith for the benefit of the other party. Such a relation ordinarily arises where confidence is reposed by one person in the integrity of another, and in such a relation the party in whom the confidence is reposed, if he voluntarily accepts or assumes to accept the confidence,

> can take no advantage from his acts relating to the interest of the other party without the latter's knowledge or consent. A 'fiduciary relation' in law is ordinarily synonymous with a 'confidential relation'. It is also founded upon the trust or confidence reposed by one person in the integrity and fidelity of another, and likewise precludes the idea of profit or advantage resulting from the dealings of the parties and the person in whom the confidence is reposed. (Civ. Code sec. 2219; Meyer v. Reimer, 65 Kan. 822 (70 Pac. 869); Robins v. Hope, 57 Cal. 493.)

It is admitted that on January 8, 1941 Merchants Ice & Cold Storage Company was a controlled subsidiary of the Holding Company, in that the Holding Company owned, in the aggregate, more than a majority of the outstanding capital stock of Merchants Ice entitled to vote.

It is admitted that Peter Bercut (though, as found by the trial Court, he may have orally resigned as an officer or director of the Holding Company) never at any time resigned, but continued to serve as a director of Merchants Ice up to and including January 8, 1941, and thereafter, and that he was appointed to that office to represent therein the interests of the Holding Company.

It is also admitted that up to and including January 8, 1941, and thereafter, Peter Bercut continued to sit on the board of directors of Pacific National Bank of San Francisco, to which office he was appointed to represent the Holding Company's interest in said bank.

It is true that on January 8, 1941 Pacific National Bank of San Francisco was not, as in the case of Merchants Ice, a controlled subsidiary of the Holding Company, but it was an affiliated institution in the sense that the Holding Company, through its subsidiary Pacific Empire Corporation, owned a very substantial interest in said bank, and said bank was the banking connection not only of the Holding Company but also of Merchants Ice and Pacific Empire Corporation.

Certainly it cannot be argued that Peter Bercut lost contact with the affairs of the Holding Company or of Pacific Empire Corporation by the mere oral resignation to Mr. Arnold, because Mr. Arnold at the time continued as president of Merchants Ice and Mr. Maffei continued as vice president of Merchants Ice, and Mr. Bercut admits that Merchants Ice met regularly every month and that the Pacific National Bank of San Francisco's board of directors, in which he and Maffei represented the Holding Company, met regularly every month. All this is disclosed by the record, and therefore the relationship between Peter Bercut, Maffei and Arnold, and among the three of them, and with the various companies involved, was not at all changed in fact by the mere expression on the part of Peter Bercut to Arnold that he didn't want to have anything more to do with the Holding Company. It isn't what one says that counts in law so much as what one does, and when it is held that Mr. Bercut ceased being a fiduciary and stood in the position of a stranger to all of these companies by his said mere oral expression, then we cut across all

the safeguards which law and equity have laboriously and persistently created for the protection of corporations, their creditors and stockholders from injury and malfeasance by scheming or otherwise unfaithful agents.

If, technically, Peter Bercut was not an officer or director of the Holding Company on January 8, 1941 he, nevertheless, continued to be and to act *as its agent* in the general administration of its affairs, and especially in the management and conduct of the principal asset of the Holding Company, to-wit: Merchants Ice & Cold Storage Company.

And, as stated by Pomeroy—4th Ed. Equity Jurisprudence, Vol. 2—Sec. 959):

> "Equity regards and treats this relation (of principal and agent) in the same general manner and with nearly the same strictness as that of trustee and beneficiary. The underlying thought is that an agent should not unite his personal and representative characters in the same transaction; and equity will not permit him to be exposed to the temptation, or brought into a situation where his own personal interests conflict with the interests of his principal and with the duties which he owes to his principal."

This same fundamental rule is expressed in *Hemmenway v. Abbott,* 8 Cal. App. 450, 97 Pac. 190.

It was held in *Robbins v. Hope,* 57 Cal. 493, at 497:

> "The phrases 'confidential relation' and 'fiduciary relation' seem to be used by the courts and

> law writers as convertible terms. It is a peculiar relation which undoubtedly exists between client and attorney, principal and agent, principal and surety, landlord and tenant, parent and child, guardian and ward, ancestor and heir, husband and wife (naming others). In these and the like cases, the law, in order to prevent undue advantage from the unlimited confidence, affection or sense of duty which the relation naturally creates requires the utmost good faith (uberrima fides) in all transactions between the parties." (1 Story's Equity Jurisprudence, Sec. 218.)

As further illustrating the meaning of these terms, it was held in *Thomas v. Whitney,* 186 Ill. 225, 230 (57 N. E. 808, at 810) that:

> "The term fiduciary or confidential relation as used in this connection, is a very broad one. It has been said that it exists and relief is granted in all cases in which influence has been acquired and abused, in which confidence has been reposed and betrayed. The origin of the confidence and the source of the influence are immaterial. The rule embraces both technical, fiduciary relations and those informal relations which exist wherever one man trusts in and relies on another."

It has been held that one can be a fiduciary of a corporation without being an officer or director. It was so decided by the United States Sup. Co. in *Southern Pacific v. Bogert,* 250 U.S. 483, at 492, where in fact a situation of dominance was found to exist.

On this point we cite to the Court the learned opinion of Justice Rosenman rendered in the case of *Blaustein v. Pan American Petroleum & Trans-*

port Co., 21 N.Y.S. (2d) 651, at page 709, where, in discussing the influences which motivated the actions of the intercorporate officers and directors, he said, at page 709:

> "Relationships, such as these men bore to the dominant corporation, are realities motivating business conduct, which loom up clearly to anyone intent on looking through the fog of intercorporate artificialities."

The same Justice, at page 712, observed:

> "The corporation which actually induces management action in its subsidiary will be treated itself as manager, and will be made subject to all the fiduciary obligations toward the subsidiary which are imposed on corporate directors themselves,"

citing, with approval, the case of *Southern Pacific Ry. Co. v. Bogert,* supra.

In *Hyams v. Calumet & Hecla Mining Co.,* 221 Fed. page 543, it was held:

> "Breach of duty and abuse of fiduciary obligation do not necessarily involve 'intentional moral delinquency'. If the act amounts to what the law considers a breach of trust, a disregard of duty, it is sufficient. Dodge v. Woolsey, 18 How. 331, 345, 15 L. Ed. 401. See Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 553, 15 S.Ct. 673, 39 L. Ed. 759. A breach of trust by one occupying a fiduciary relation, even while in the exercise of a lawful power, 'is as fatal in equity to the resultant act or contract as the absence of the power'. Jones v. Electric Co. (C.C.A. 8), 144

F. 765, 771, 75 C.C.A. 631; 3 Clark & Marshall on Corporations, p. 2289."

As was said by Welsh, District Judge, in the elaborate opinion filed by him in the very recent case of *Overfield v. Pennroad Corporation,* 42 Fed. Supp. 586, at page 607,

"The existence of control is the important consideration, and not the means adopted, which creates the fiduciary relationship and the exercise of such control, regardless of the device employed, which fixes the liability."

In *Geddes v. Anaconda Copper Mining Co.,* 254 U.S. 590, 599, it was held:

"The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation."

Therefore, it becomes apparent that the failure of Mr. Justice Stephens (concurred in by Mr. Justice Garrecht) to consider appellant's points as set forth on pages 90 et seq. of our opening brief constitutes a material error in law on the part of the Court, for the very reason that the entire case of appellant is predicated on the proposition that Peter Bercut, on January 8, 1941, was a fiduciary of the Holding Company, and if, in fact he was a fiduciary, then, under the rules of law as expressed in the cases cited in our opening brief at pages 90 et seq. then the question of adequacy of the consideration is at most secondary,

because it is elementary that a fiduciary has the burden of proving that he did not take advantage of his position; that he acted fairly, above board and with the full knowledge of all of the directors; and that he was dealing at arm's length and with the properly authorized officers and directors of the Holding Company. See the opinion of Mr. Justice William O. Douglas in *Pepper v. Litton* (supra), at page 306, and *Veeser v. Robinson, etc.,* 275 Mich. 133, 266 N.W. 54, wherein the Supreme Court of Michigan said:

> "The rule which permits a director of a corporation (in other words a fiduciary) to deal with it, even in good faith, is limited to those cases where the corporation is represented by a quorum of disinterested directors or other independent officers or agent authorized to contract for it, *and, even then, the burden of showing the validity of the contract and the fairness and honesty of the dealings of the director with the corporation is on him.*"

Furthermore, a consideration of the nature of the transaction itself and the manner in which it was accomplished could only lead to the conclusion that defendants Maffei and Arnold were not themselves *disinterested* directors, representing solely the corporation, protecting only its interests, but were, in fact, interested only in preserving themselves and covering up their own defalcations. Otherwise it would seem reasonable that they would have tried to dispose of this substantial asset to others who had expressed an interest or desire to purchase it. Therefore, the corporation, in the transaction of January 8, 1941, was not

represented by disinterested directors properly authorized to act for it in the particular matter, and, assuming that Peter Bercut continued to be a fiduciary, by virtue of his continuing relation, then there certainly has been no compliance with either the mandate of our Supreme Court as laid down in *Pepper v. Litton* (supra) nor with the requirements of Section 311 of the Civil Code of California, or the decisions of the State of Delaware applicable to transactions by fiduciaries, which decisions have been cited in our opening brief.

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(2) RULE 52(a) OF THE RULES OF CIVIL PROCEDURE DOES NOT NARROW THE POWER OF THE APPELLATE COURT TO REVIEW AND MODIFY FINDINGS OF FACT IN AN EQUITY CASE.

The majority opinion of the Court appears to be based upon the erroneous proposition that, by virtue of Rule 52(a) of the Rules of Civil Procedure the Appellate Court has not the right in this case to draw its own findings and conclusions upon a study of the entire case and review of all the evidence.

It is respectfully submitted that Rule 52(a) of the new Rules of Civil Procedure does not narrow the power of the Circuit Court of Appeals to review the findings of fact of a chancellor in an equity case, and to weigh the evidence and, if necessary, for the purpose of doing complete justice, to revise the findings.

It is true that under the new rules there is now only one form of civil action, and the new Rules of Civil

Procedure are applicable to both actions at law as well as in equity. But, as stated in Montgomery's Manual of Federal Jurisdiction and Procedure (Fourth Edition), at page 1137:

> "The rule stated in the third sentence of Subdivision (a) (Rule 52) accords with the decisions on the scope of the review in modern federal equity practice."

See also *Guilford Const. Co. v. Biggs* (4 Cir.), 102 Fed. (2d) 46 at page 47.

On appeals in equity, findings of fact made by the Court below are entitled to some weight, but are not binding on the Appellate Court. The whole case is before the latter Court and it is bound to decide the same, so far as it is in a condition to be decided, on its merits. It was so held in *Waterloo Mining Co. v. Doe* (C.C.A. 9th), 82 Fed. Rep. 45 at page 51, where this Court said:

> "It is further urged by the appellees that this court is bound by the findings of fact of the Circuit Court, unless they are found to be clearly and palpably erroneous. On an appeal in an equity suit the whole case is before the Court, and it is bound to decide the same, so far as it is in a condition to be decided, on its merits. Beach Mod. Equity Practice, page 978; Ridings v. Johnson, 128 U.S. 212, 9 Sup. Ct. 72; Garsed v. Beall, 92 U.S. 684-695; Johnson v. Harmon, 94 U.S. 371.
>
> If a case has been referred to a master, and he has made findings of fact, there ought to be exceptions to the same, if any party to the suit is dissatisfied therewith, and a ruling upon the same made by

> the chancellor. If this course is not adopted, then findings cannot be reviewed on appeal. It is to be observed, however, that the findings of fact by the Circuit Court are not without some weight in considering the merits of the case. This case, therefore, is presented to this Court upon its merits, and must be considered upon the evidence with such aid as may be found in the findings of the Circuit Court."

See also *Simkins Fed. Practice* (Revised Edition), Sections 1016 and 1020, and the case of *Boynton v. Moffat Tunnel Imp. Dist.*, 57 Fed. (2d) 769 at 777.

That the proceeding here in issue is of an equitable nature there can be no doubt. The complaint, as a whole, seeks to set aside a transaction on the ground of invalidity, the restoration of property allegedly taken without right, and the impressment of a trust upon the property in question. The relief sought is clearly of an equitable nature, and, although the second and third causes of action are legal in nature, it is clear that they are mere outgrowths of the first cause of action, and are referable to it. The complaint must be looked at in its entirety to determine the nature of the cause of action pleaded and relief sought. So doing, it is obvious that the proceeding here in question is an equitable proceeding, imposing upon this Court "the duty to decide the same, so far as it is in a condition to be decided, *on its merits.*"

(3) THE FINDING OF THE TRIAL COURT THAT THE CONSIDERATION PAID BY PETER BERCUT WAS FAIR AND ADEQUATE IS CLEARLY ERRONEOUS.

The majority opinion of this Court states that: "In view of the evidence elicited, the finding as to reasonable value of the shares is not clearly erroneous." In his dissent, Wilbur, Circuit Judge, states that, in his opinion, the evidence shows that the consideration paid by Bercut to the Pacific Empire Holdings Incorporated was neither fair nor adequate and that the trial Court's conclusion on the facts was clearly erroneous.

We respectfully state that we are at a loss to understand how, under all the facts of the case, the nature of the evidence elicited on behalf of the appellees, whose duty, under the law, it was to prove payment of an adequate consideration and the existence of fair, open and above board dealing, could possibly be deemed sufficient to warrant the finding made by the trial Court on this point.

In the case now before the Court Pacific Empire Holdings, Inc., on January 8, 1941, owned 65,865 shares of common stock out of 107,188 shares outstanding, or approximately 63% of the common, and 12,495 shares of 7% cumulative preferred stock out of 41,615 shares outstanding, or approximately 30% of the preferred.

The par value of the preferred stock was $10 a share, and as of December 31, 1940 the amount of unpaid accumulated dividends due thereon amounted to approximately $9.57 a share.

It is admitted that these shares were not listed on any markets and that occasional sales of both common and preferred were made over the counter with the buyers generally either Pacific Empire Holdings, Inc. or Peter Bercut. As testified by Mr. Maffei, at page 181 of the transcript, there was little activity in the stock and once in awhile a few shares would be offered, and, to quote his own testimony, they (the Holding Company) would pick it up at the least possible price. (R. 182.) It is obvious and generally recognized that in such a situation the price at which such infrequent sales are made or the bid and asked prices posted is not any criterion or proper test of the intrinsic reasonable value of a block of stock such as is embraced in the transaction of January 8, 1941.

We have in the record on this point the uncontradicted testimony of H. R. Baker, an expert on securities, which reads as follows:

> "Q. From your experience in unlisted securities are you in a position to state whether or not when a majority of the stock is owned by a concern and there are occasional sales transactions on outstanding stock, whether the market for such stock and such transactions reflect the true reasonable value of those securities?
>
> A. Not necessarily. It all depends on where the control is and what kind of a control it is and what they are doing for the outside stockholders.
>
> Q. Where a situation exists that the transactions are very rare and only involve a small number of shares, and the purchasing power, as it were, is limited to the controlling interest, would the price at which such securities would occasion-

ally be sold be a true reflection of the reasonable value?

A. I would say they would have no reflection on the reasonable value, unless the parties who were making the market wanted it such."

In order to determine whether or not Pacific Empire Holdings, Inc. received adequate consideration for the transaction entered into with the defendant Peter Bercut as expressed in the form of letter agreement under date of January 8, 1941, it is essential that this Court keep its eyes fixed not on any loose and irrelevant analysis of either the then alleged market value of the outstanding shares of Merchants Ice publicly owned and occasionally traded on the over-the-counter market, or the alleged intrinsic value of the underlying assets of the company broken apart and reduced to bare land, or bricks, mortar and machinery and sold under the hammer. Rather, this Court must approach the problem from an overall picture of the company as a "going concern" engaged for over fifty years in a vital public utility business under the regulation of the Railroad Commission of the State of California, occupying one of the choicest and most compact locations on the San Francisco Embarcadero, fed by shipping lines and railroad and spur track facilities unexcelled in any other part of the city, enjoying, through long periods of prosperity, or depression, by far more than half of the cold storage and ice business of this metropolis, and, according to all of the witnesses, about to enter into one of its most profitable periods.

We are not dealing here with mere book valuations. The valuations to which we shall refer are those used by the company and accepted by the Railroad Commission of the State of California as the basis of determining the invested capital used in the operation of the business.

It is obvious that the only equitable way for ascertaining the reasonable intrinsic value of the block of stock of Merchants Ice, embraced within the transaction of January 8, 1941, is through an analysis of the net worth of Merchants Ice applicable to its outstanding capital stock after giving effect to certain reasonable allowances which should be made upon consideration of all of the circumstances surrounding the company, its past operations, its then financial condition, its prospects for future improvement—all considered from the overall point of view that it is a going concern, not in course of liquidation, and that the block of stock in question constituted more than a majority of the outstanding capital stock, thus assuring perpetual control over its management.

In such a case the true and just rule of valuation is expressed in *Gerdes on Corporation Reorganization,* Sec. 93, page 245, where the learned author states:

> "In a number of decisions it has been held that the going concern value of an active business must be considered in determining the fair value of its property. Fair value is not the value of the property after its going concern value has been reduced or destroyed by the intervention of bankruptcy proceedings, or by a levy and execution on the property of the debtor."

In the case of *In re Gibson Hotels, Inc.,* D. C. 24 Fed. Supp. 859, 863, involving a case of valuation under the Bankruptcy Act, the Court said:

> "The 'fair valuation' contemplated by the statute is not the value at which such assets could be converted into cash on a distressed market or at forced sale, but is the value of the assets taken in their relationship to the business of the hotel as a going concern. In re Bucyrus Road Machinery Co., 6 Cir., 10 F. (2d) 333; In re Nathanson Bros. Co., 6 Cir., 64 F. (2d) 912. To apply this test of value to a hotel property, it is necessary to take into consideration all of the elements entering into the intrinsic, as well as the selling value of the real estate, and also the earning power of the property."

In the case of *In re Crystal Ice & Fuel Co.,* 283 Fed. 1007, at 1009, the Court laid down the following rule in determining valuation:

> "Salable value and fair valuation are not synonymous, and the conclusion "wholly insolvent' because of the fact that the 'salable value' of the company's property was less than its debts may be and is proven to be not at all the insolvency of the Bankruptcy Act, viz. Insufficiency of its property at fair valuation to pay its debts * * * That is, although his property be not presently salable for enough to pay his debts, its fair valuation may be more than enough; and if so, he is not insolvent nor subject to bankruptcy for insolvency."

In the very recent opinion from our District Court of Appeal of California, First District, handed down

March 3, 1944, in the matter of the sequestration of the Pacific States Savings & Loan Company by the California Building & Loan Commissioner, Justice Ward, speaking for the Court, on the contested point of whether or not the trial Court was justified in refusing consideration of "going concern" value in determining the fair value of the assets of the sequestered company, said:

> " 'Going concern' may not be strictly defined to fit all cases. It is sufficient to say that ordinarily any element that tends reasonably and legitimately to enhance the value of property rights based upon the existence of the business in which they are involved, may be taken into consideration in ascertaining the full value of those rights. Reasonable discretion should be used in determining the meaning of this term as in the case of determining any market value; fair market, cash, actual cash, full cash, true cash, intrinsic, normal or other designated values not defined by the governing statute.
>
> The difference between 'going concern' and 'cash' value is of paramount importance in this case. It is the difference between a business operating in an orderly manner, whether under good or difficult conditions, and with the chance of working out in case of the latter, and one suddenly arrested, the immediate result of which is to eliminate the element of going concern, and to place assets at the mercy of speculators regardless of the interests of certificate holders who are vitally concerned in whether their investment shall be given a chance to survive."

That the control feature of a block of stock is to be considered as a factor in determining the reasonable value thereof goes without question. It was so held in the very pertinent and parallel case of *Potter v. Sanitary Co. of America,* Del. Chanc. 1937, 194 Atl. 87, where the rule is laid down as follows:

> "The only testimony the defendant has offered relates to the value of Sanitary stock when it was sold to Sanitary. That testimony is that recent sales of the stock showed it to have a market of not over two dollars per share. Hence, they say, the price received by Consolidated was a fair price. But even a fair price cannot justify corporate officers in making a sale if the purpose and effect of the sale is to advantage themselves either in position, power or profit to the disadvantage of the corporation they represent.
>
> Was the price, however, a fair one, in view of the circumstances? The defendant refuses to allow any value to Consolidated's block of Sanitary stock on account of the control of Sanitary which the block carried. *In this they are wrong.*"

In arriving at a determination of the net worth of Merchants Ice allocable to its outstanding capital stock and the block of shares in question, the only true, reasonable and fair means of approach is by analyzing the annual reports of the operation and financial worth of this company prepared by such reputable accounting firms as Haskins & Sells, which audited the books during the years 1936, 1937 and 1938—and John F. Forbes & Co. which made an audit as of December 31, 1939, and comparing these audits with

the financial report of the company dated December 31, 1940, the last of which, on February 19, 1941, was sent out to the stockholders of the company by none other than the defendant Peter Bercut.

The audit report of the company made by Haskins & Sells for the year 1938 is to be found at page 405 of the record in the testimony of A. W. Haynes, a member of the firm. He there testified that the total assets of the company on December 31, 1938, amounted to $2,153,809.33, and that all of the liabilities of the company, current and fixed, and other charges, aggregated $882,894.63, leaving a net worth allocable to the preferred and common stock as of December 31, 1938 of $1,270,914.70. This was equivalent to $18.17 for every share of preferred stock outstanding, leaving a balance of $514,764.70 of equity assets available to the common stock, or $4.80 per outstanding common share.

Now, it is true that these are book values, but as pointed out by Mr. Haynes, at page 407 of the transcript, they were sound values acceptable to the Railroad Commission for rate purposes, and arrived at as follows:

> "Q. Now, in arriving at the net worth of the company upon what were the values of land, buildings and equipment arrived at, that is, what was the formula used?
>
> A. The value of the land and what we generally term the fixed assets was based on an appraisal made by the American Appraisal Company in 1927. To that had been added subsequent additions and there had been deducted retirements up to December 31, 1938.

Q. That is the land?

A. That includes the land, buildings, machinery, equipment, fixtures, and other terms of property.

Q. Now, what formula was used in determining the depreciation on all of these buildings and equipment?

A. At the time the American Appraisal Company made its appraisal in 1927 it recognized what is termed a composite rate of 3¼ per cent, and the company followed that rate of depreciation throughout the period with which I am familiar at least.

Q. Let us take 1938. Was the amount of depreciation allocated the concern for the year based upon that formula?

A. For 1938 the provision for depreciation amounted to $73,614.24.

Q. In 1937 how much was the provision for depreciation?

A. It was something less—$600 or $700 less. I can give you the exact figures for 1937; the provision for depreciation was $72,486.71.

Q. Now, in arriving at the net worth of the company as of December 31, 1938 how much depreciation had been taken on the buildings, machinery and equipment up to that time?

A. In the aggregate the reserve for depreciation as of December 31, 1938 amounted to $1,185,957.71.

Q. Leaving a net value, in other words, for buildings, machinery and equipment on December 31, 1938 of what figure?

A. Exclusive of land?

Q. Exclusive of land.

A. $1,083,094.70.
Q. Now, the land was carried at what figure?
A. $890,608.55.

The net worth of the company as of December 31, 1939, as shown by the audit of John F. Forbes & Company (Pl. Ex. 38, R. 521) was $1,253,150.94, or $17,763.76 less than the net worth as of December 31, 1938. This reduction reflects an operating loss for the year, after making allowance for depreciation in the sum of $74,852.67 in that year. (R. 523.)

No audit of the operations of the company for the year 1940 was made, but the defendant Peter Bercut, who had become president of the company following his acquisition of the shares in issue on January 8, 1941, sent a financial report to the stockholders, which is dated February 19, 1941, and found at pages 368 and 369 of the record. In that report he states that the net worth of Merchants Ice, as of December 31, 1940, was $1,199,136.50, after making due allowance for all charges, including depreciation of over $70,000.00 for the year and all accumulated surplus deficits.

If we allot to the 41,615 shares of preferred outstanding the sum of $19.57 a share, being the par value, and all accumulated dividends, or an aggregate of $814,405.55 we still have a balance of $384,730.95 of such net worth allocable to 107,188 shares of common stock outstanding, or approximately $3.50 per share. On this basis the 12,495 shares of preferred stock delivered to Bercut on January 8, 1941 had a

book value of $244,527.15, and the 65,865 shares of common delivered to Bercut had a book value of $231,186.15, or an aggregate book value of $475,713.30.

It is true that for 8 or 9 years during the depression and continuing right through 1940, while under the management of these very defendants, the company showed a continuing operating loss in its business reflected in an earned surplus deficit of $216,588.50 by December 31, 1940. (See R. 373.) But, if we consider the fact that during these same years the company had charged off, as an expense, an average of almost $70,000.00 a year in depreciation alone on its plant and equipment, this earned surplus deficit loses much of its significance. Also, one must consider the fact, and never forget it, that during all of these years the management of this company by these defendants was no different than their management of the rest of the companies. In other words, it was a case of spoliation, and yet in spite of all of the mismanagement and all of the looting and spoliation, this company at no time, even during the bottom of the depression, when all of its competitors were going under throughout the United States, ever defaulted in the payment of any of its obligations or in the payment of its interest or of the principal due on its outstanding bonds. Every obligation at all times was met as it matured, at the expense, it may be, of its working capital, but nevertheless met.

The fairest and most objective analyses of the value of the block of stock delivered by the defendants

Maffei and Arnold to the defendant Bercut was made by the witness Wm. F. Morrish, president of the Bank of America from 1931 to 1934, formerly president of the First National Bank of Berkeley, and at the time president of the American Toll Bridge Company. Mr. Morrish had been appointed chairman of the directors of Merchants Ice in 1938 at the behest of Crocker First National Bank of San Francisco—trustee under the bond indenture. He was appointed for the purpose of protecting the rights of the bondholders. He was a wholly disinterested witness. He owned no stock in any of the companies involved.

At page 453 of the record he states that during his term of office as chairman of the board of Merchants Ice he observed and watched closely the activities and progress of this company and kept a "running record of its activities" so that he could report to his people—the bondholders.

At page 457 he testified that during the period he was chairman of the board the condition of Merchants Ice showed steady improvement. In 1940 he was asked by defendant Arnold to make a loan of $3000.00 to the Holding Company, which he did, secured by 1500 shares of Merchants Ice, and on page 458 of the record he states that he considered this to be ample security for the loan. In other words, in 1940, a few months before the Bercut transaction, Mr. Morrish made a loan equal to $2.00 a share on 1500 shares of common stock of Merchants Ice, and he, a banker, thought it was ample security. On pages 458 to 461 of the rec-

ord Mr. Morrish gave the following testimony bearing on the value, as of January 8, 1941, of the block of shares here in issue:

"Q. Will you please state, Mr. Morrish, from the records that you have kept in your own handwriting, as I have observed, and from the financial reports of the company which you have examined, and from your own knowledge of the condition of this company what in your opinion was the reasonable, fair net worth of this company at the end of the year 1940, after making full allowance for all of its obligations and liabilities?

A. Well, I would have to refer to some figures that I have here.

Q. Will you please state to what you are referring?

A. As I stated, I have kept a running account of the comparison of the assets and liabilities of the company, and figured that the company in 1940 was making progress and that we were just on the verge of going into a period of very good times when it was sold. The figures that I have got down here were what I called distress figures, and figures that I believe the company could have liquidated for.

Q. By the company you mean the Merchants Ice & Cold Storage Company.

A. The Merchants Ice & Cold Storage Company, yes. The assets as I wrote them down were $1,576,000.

Q. At what time?

A. I reduced the land values down to $700,000 as compared with the book value of $865,000. I

am just giving the regular figures, not the odd figures. The buildings I reduced from $1,003,000 down to $750,000, and the real estate—there was a small item of other real estate that I put in at $20,000. The cash, of course, was the accounts receivable, the same, because they had already set up a reserve for loss, and the bottles that they had for sale, which were later sold at $7,500, giving me a total of $1,576,000. That is a reduction in the assets as shown by the books of over $400,000—between $400,000 and $450,000.

Now, on the liabilities side, I figured the bonds had to be paid in full at $659,500. There was an indebtedness to Pacific Empire of $9,500, which I included, and mortgage on other real estate of $12,000; notes payable $3,200; accounts payable $160,000, and a reserve for contingencies $15,000, or a total of $859,000. Now, that left a net value or a knockdown value, as I expressed it, of $716,000. I considered the preferred stock was probably worth its book value.

Q. That is $10 a share?

A. $10 a share.

Q. Par value, you mean by saying 'book value'?

A. The par value, not the book value. That left in the neighborhood of $300,000 value for the common stock.''

The method used by Mr. Morrish in arriving at his valuation is to be found in Defendant's Exhibit E on page 471 and Defendant's Exhibit F on page 474 of the record.

Defendant's Exhibit F is the so-called running record kept by Mr. Morrish, and it is interesting to study it for it proves how accurate were his observations and how fair his approach to the problem. It is a running record by months, skipping only the month of July in 1940. His Exhibit E is a breakdown of the assets of the company as of December 31, 1939, and his own independent valuation of these assets. He there appraises the value of the assets of the company at less than their book value. He reduced the book value of the land from $865,608.55 to $700,000.00, and the book value of the buildings from $1,003,302.97 to $750,000.00. In addition to that he throws out, as valueless, an item of $26,477.40 carried as "Investment not Secured"; an item of $23,874.94 due from Globe Brewing Company, then bankrupt, and an item of $59,772.25 carried under "deferred charges", or an aggregate reduction of $536,988.53 in the book value of these assets. After making this arbitrary reduction in valuation, which he thought was fair and reasonable, considering the past history of the company's operations, the net actual—as distinguished from book—value of the assets of the company were found by him to be $1,576,059.97, and deducting therefrom all of the liabilities of every kind and character aggregating $859,826.96 there was left a net value applicable to the outstanding preferred and common stock of $716,233.01. *At page 479 of the record Mr. Morrish testified that his valuation was a liquidating valuation.* In other words, in the event of liquidation, according to Mr. Morrish, the net value of the equity

assets would be equal to approximately $17.50 per preferred stock outstanding and thus the 12,495 shares of preferred stock delivered to Bercut under the agreement of January 8, 1941 would be reasonably worth approximately $216,000, while the common stock would have no liquidating value but would have an intangible value based upon the fact that it represented control.

But, as we have said before, this was not a liquidating business. This was a business that had been going on for over 50 years and was about to enter into one of its most prosperous times, as Mr. Morrish testified on page 486 of the transcript. Mr. Arnold testified (R. 881) that the general condition of the company at the end of 1940 "was better", and the report sent out by Mr. Bercut at the end of his first year of operation proves it. Therefore, we cannot take the liquidating values placed on these assets as a fair criterion of their true worth. Rather, following the rules of valuations hereinbefore cited, we should add to the valuation made by Mr. Morrish the additional value created by virtue of the fact that the company was a going concern which had successfully weathered a stormy career and was just entering a period of renewed prosperity, and the further consideration that the block of stock in issue represented more than a majority of the shares outstanding. These factors fully justify the reasonable and conservative valuation of Mr. Morrish and fully warrants the testimony given by him at page 498 of the record where he testified as follows:

"Q. In other words, you are now stating for the purpose of the record in your opinion anyone who paid the equivalent of $2.80 a share for 65,000 shares of common and $10 a share for 12,000 shares of preferred from the Pacific Empire Holdings on January 8, 1941, would have paid a fair price?

A. Yes."

Finally, let us briefly, analyze the testimony of appellee's witness, Louis T. Samuels.

Mr. Samuels' task was simple. He came to Court with the precenceived intent of testifying to a value of $1.00 per square foot for the property of Merchants Ice. Let us consider some additional facts. Here is the largest single parcel of private property on the San Francisco Embarcadero. Unexcelled spur track and shipping facilities, both indispensable to a cold storage plant; over three acres of ground space, occupied with specialty buildings adapted to their particular requirements; a going concern in existence for fifty years. To what does Mr. Samuels compare this consolidated operating unit? Principally to spur track property and government storage property located not down by the Merchants Ice plant, but over by Fisherman's Wharf where the government has engaged in great activity since the war. Examination of the parcels used for comparison (R. p. 660) clearly shows these facts. With only two parcels is Mr. Samuels familiar. One, with a 68-foot frontage, with a sixty-year-old building (and according to his testimony (p. 660) such a building is valueless) he sold

to his brother for $10,000.00, or $145.00 a front foot. The Merchants Ice property has over 2200 feet of street frontage. (See Ex. M, p. 657.) The other property (R. 668-669) he calls a block. It had 500 feet of street frontage with 17,000 square feet of land, improved with a cracked and obsolete building. He sold it for $14,500.00, or $290.00 a front foot. On cross-examination, he reveals that the property produced about $1500.00 a year gross income after taxes, but before insurance, maintenance, depreciation, etc. Although Mr. Samuels calls it a block it is really only a large lot approximately 130 x 130 and obviously it sold on an income basis of about 10% a year gross after taxes.

Mr. Samuels entirely ignores the plottage value of owning a single unit covering nearly three blocks improved with buildings adopted to the business. Having determined on $1.00 per foot he sticks to it through thick and thin. Yet if we consult Mr. Samuels' summary (pp. 657, 658) we find he is not unaware of going concern value, because, although in his analysis on pages 659 and 660 he considers items 2, 3, 5, 7 and 8 obsolete and almost valueless, he nevertheless appraises the improvements on those parcels for $153,000.00.

Illustrative of the wholly unreliable character and worthlessness of the testimony of witness Louis T. Samuels is this glaring and irrefutable point, namely: The trial of this action began April 20, 1943, or more than three years after the deal with Bercut. In defendants' Exhibit "M" page 657 of the Record, we

have Mr. Samuel's valuations, under date of April 16, 1943, wherein he says, substantially, that the aggregate value of the properties listed by him in said letter as of January 8, 1941, were $548,559. *But at Record page 664 Mr. Samuels admits that his appraisal did not include any of the machinery and equipment in all of these buildings, and, obviously, he gave no effect to the concern as a going business, in spite of the fact that this very company, these very properties were adequate to take care, in 1942, of a volume of business amounting to $846,821.06, and result in a net profit to the company of $156,401.98, after all charges, including depreciation, on the same buildings, machinery and equipment, of $77,124.68 for the year.*

Let us consider here the Evans adjustment of accounts receivable. Appellees vehemently deny the Bercut sale rendered his vendor insolvent. Why then the charge-off of the vendor's account receivable? Here they are blowing hot and cold. If appellant was solvent, the account was good—if appellant was not solvent the charge-off was justified. The answer, of course, is that the account was good as long as appellant had the stock of Merchants Ice as an asset and only so long. The write-off was justified after the Bercut sale *and because of it.*

Finally, Mr. Evans and appellees' brief make no reference to the $26,500.00 reserve for bad accounts and the $15,000.00 reserve for contingencies which were ample provision for bad accounts if the Holding Company account was good, which it was prior to the Bercut deal.

Finally, since candor is due the Court, let us examine the comparative balance sheets at December 31, 1940, and December 31, 1941. (p. 371, Pl. Ex. 32.) This is the balance sheet prepared at the end of the first year of Bercut control. Where are any of the adjustments so vehemently argued in appellees' brief? Let us examine Exhibit for Plaintiff No. 33 (p. 374), being the balance sheet at the end of 1942, and still we find no such adjustment. How can the publication of those balance sheets be reconciled with the claims of the appellees with respect to the necessity of such adjustments? Either the present management of Merchants Ice is misrepresenting facts or appellant's contentions are justified.

According to the balance sheet prepared for Peter Bercut at the end of 1941 (p. 371) the common stock at December 31, 1940, had an equity in substantial assets of $782,982.50 or $7.30 per share. If provisions for dividend arrearage on the outstanding preferred stock be made, the equity behind the common stock is reduced to about $3.25 per share, on which basis, of course, the preferred stock increases in value to $20.00 per share. In other words, according to the statement prepared by the Bercut management, the stock Bercut received from Maffei and Arnold had a book value at December 31, 1940, before provision for dividends in arrears, as follows:

12,495 shares	preferred at $10.00	$124.950.00
65,683 "	common at 7.30	480,799.90

after providing for preferred dividends in arrears:

12,495 shares	preferred at $20.00	$249,900.00
65,683 "	common at 3.20	214,054.75

Assuming, without conceding, some adjustment should be made because of possible overstatement of assets or understatement of liabilities, the adjustment in total never could equal an amount sufficient to cause the Holding Company's equity ratio of the adjustment to reduce the value of its holdings to the ridiculous sum of $35,000.00.

It is, of course, true that because of the depression from 1929 to 1933, and as a result of the mismanagement of the company by these very defendants, the working capital of Merchants Ice had been depleted and it temporarily faced a period where it was compelled to defer some of its immediate obligations. But this condition did not at all impair the solvency of the company as proven by the testimony of Mr. Gaither, president of Pacific National Bank, who substantially testified, at page 503 of the Record, that the loans of the company were in good standing and that he was not worried about them. Nor can it reasonably be said that this temporary tight working capital situation had the effect of destroying the intrinsic net worth of the company, or the basic values of its assets, and this is proven by the fact that as soon as the defendants Maffei and Arnold left the company and the defendant Peter Bercut took over the management, all of the pressing financial problems that the respondents so exaggerate in their brief seem to have evaporated and the company began to show profits instead of losses.

The failure of the trial court to give adequate consideration to these irrefutable facts renders its finding on this phase of the case clearly erroneous.

CONCLUSION.

It is respectfully submitted that a rehearing should be granted.

Dated, San Francisco, California,
January 26, 1945.

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CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for appellant and petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco, California,
January 26, 1945.

A. J. SCAMPINI,
Of Counsel for Appellant and Petitioner.